

INTRODUCTION

The financial stability of the City of Springfield Police Officers' and Fire Fighters' Retirement System has declined significantly over the last several years. A number of factors have led to this problem including lower than projected returns, the amount of the contributions made by the City of Springfield and changes in the demographic assumptions. Although efforts have been made to remedy the problems, the situation is likely to continue to deteriorate without significant intervention.

At the present time, the Plan has approximately half of the assets needed to pay for promised benefits. The number of active employees supporting retirees has declined from 1.36 in 2004 to 1.14 in 2007. Over this same time period, the City's contribution has increased 38% to the current contribution rate of 28.88% of salary. However, the contribution rate recommended by the actuary is 50.21% of salary. While the rate of return on investments has significantly increased due to changes made to the investment policy, increased investment returns will not solve the long-term problem.

The management of the Plan is established by City Council and carried out by the Board of Trustees. The Board of Trustees administers the Plan according to the ordinances passed by City Council and manages the investments. The Trustees take these responsibilities seriously, as well as our fiduciary duty to act in the best interest of the Plan. We feel it is appropriate to express our concern to the members of City Council and to offer a proposed solution for your consideration.

BACKGROUND

Milliman, the Plan's actuary consultants, commented in their 2006 actuarial valuation on the steady erosion of the funded status of the Plan. The report listed four ways to improve the Plan's funded status: improve investment returns, increase contributions, reduce future benefit liabilities or some combination thereof.

- In 2005 the Board of Trustees contracted for an independent performance audit to evaluate the Plan's investment performance. All of the recommendations have been implemented. The return on investments has improved and investment fees in the Plan have been reduced by 30%.
- The City has increased the contribution rate from 23.83% of salaries in 2005 to the current rate of 28.88%.
- In addition to increasing the annual contribution rate, the Council directed an additional \$500,000 lump sum contribution to the Plan in the 2008 budget. Also, \$500,000 of the settlement received from a recent lawsuit was put in the Plan.
- The City has addressed some of the demographic issues that were contributing to the need for additional funding. Unlimited accumulation of vacation was capped

in 1995 at two times the annual accrual rate. Holiday pay amounts were capped in 2004. Additionally, employees hired prior to 1995 are not allowed to accumulate more vacation leave than the balances they had in 2005 if they were over two years of accumulation. Lastly, employees hired after June 1, 2006 are not able to include any leave payouts into their pension calculations. These changes are already beginning to decrease the spike in retirement pay and will continue to positively impact the fund in the future.

- Despite these efforts, the funded ratio of the Plan is continuing to deteriorate. A significant amount of cash is needed, in addition to the ongoing contributions to return the Plan to a healthy condition. To reach an 80% funded ratio, \$83.4 million is needed. A 90% funded ratio requires \$111.2 million.

The long-term viability of the Plan depends on an increase in funding. Improving investment returns alone will not fix the Plan.

- A subcommittee report to the City Council dated February 14, 2006 noted that returns above the assumed rate due to the new investment strategy “will begin to contribute to [improvement of] the overall problem, but will fall short of fixing the problem.” The report went on to conclude that the funding “gap will continue to grow unless steps are taken to find ways to address the shortfall.”
- An actuarial report dated November 2005 stated, “The City has substantially increased contributions to the Fund in the last few years. [However,] even more substantial contributions increase will be required to improve the funded ratio in a significant way.”

LEGAL CONCERNS

- The City is required to provide the actuarial recommended contribution rate for at least one of the next five years or the State will withhold up to 25% of the revenue due to the City. For fiscal year 2009, this means the City would have to increase its contribution by \$5.1 million or 7% of the general fund budget. This would require significant budget cuts.
- It is unlikely a budget can be developed that appropriates the required contribution without cutting vital services to the community. Cutbacks would likely include public safety positions, since this comprises 51% of the general fund budget. Staff reductions in other departments would also be required.
- Staffing reductions in the Police and Fire Departments will result in fewer active employees supporting more retirees in the Plan, only making the pension problem worse.

- Assuming the above-described cuts could be carried out this year, the actuarial assumptions for succeeding years will require even greater cuts in order to meet the actuarial recommended contributions. This means there is no “one-time cut” that will fix the Plan.
- Funding the plan solely from the General Fund will limit the City’s ability to provide adequate pay to all City employees. Additionally, if the City is not able to provide regular cost-of-living raises, this will negatively affect the pension plan and will require a higher contribution rate.
- The long-term impact to the citizens’ businesses in the community would be detrimental not only to the quality of the services provided, but also financially. If staffing is cut, the fire department’s ISO rating will be negatively impacted and would likely result in increased insurance rates to business owners.
- Cuts to the budget, at the level that would be necessary, would impair city services and would also demoralize city employees. The ultimate result would be a decline in the quality of employees the city will be able to hire and retain without resulting in any significant permanent benefit to the Plan.

ANALYSIS OF PLAN

The Board is interested in a solution that will fix the Plan permanently and not one that will only delay the crisis for a few more years. The Board asked the actuary to analyze the impact on the funded ratio of the Plan using a City contribution rate of 28.88% and additional funding from a public safety sales tax.

- If the City does not increase the 28.88% contribution rate and no additional funding is put into the Plan, the Plan will be depleted in about 20 years.
- If the City makes 100% of the required contribution every year, the Plan will be 80% funded in 2023 and 90% funded in 2031. A previous actuarial study showed the City’s contribution rate would increase to 80% of payroll in 2015 and only achieve a 70% funded ratio. The fund would not be healthy for a number of years and would be subject to changes in the market that may adversely impact the funded ratio over this period of time.
- If a sales tax is passed to provide additional funding to the Plan and the investment assumptions are realized, the following ratios are estimated.

<u>Tax Rate</u>	<u>90% Funded Ratio</u>
1%	3 years
.50%	8 years
.25%	19 years

- The funded ratio was projected using a .375% tax rate and a .50% rate and discontinuing the tax when the funded ratio reached 80%. In both cases, the funded ratio started to drop when the tax ended.
- The Board considered issuing bonds to provide one-time cash injection into the Plan. The bonds would be repaid with the revenue from a public safety sales tax. The Board determined this approach was too expensive and would require the tax remain in place for a longer period of time.
- We were surprised to learn there is little difference in the funded ratio if the Plan remains open or if it is closed to new participants. The Board recognizes the decision to leave the Plan open, or close it, is a policy decision of City Council. We offer the following points for Council's consideration. The demographics of a closed plan are different than an open plan. As the number of participants age and are closer to retirement, the asset allocation will have to become more conservative. The investment returns will be likely be lower as a result, adding further pressure to the long term viability of the Plan. If the Plan remains open, safeguards should be implemented before any benefit increases are approved. Benefit increases that cause the funded ratio of the Plan to drop below 90% should not be approved. Retroactive benefits should not be granted and the actuary should cost out all benefit increases separately. Additionally, the City should always fully fund the cost of any benefit increase.

We encourage the Council to fully explore the impact of both alternatives before making a decision.

RECOMMENDATIONS

The Board believes a dedicated tax is needed for the Plan to be healthy and sustainable so that the benefits promised to employees can be delivered. The Board recommends the City Council put forth a ballot issue for a public safety sales tax.

- The Public Safety Sales Tax and the existing level of City contributions would be dedicated to making the required contribution to the Plan.
- The tax should be set at a level to reach and maintain a 90% funded ratio. The tax should be sunset in the number of years estimated to reach this funded ratio.
- A minimum of .50% sales tax is needed if the funded ratio is to be reached in a reasonable amount of time. If the tax is set at 1%, the Plan could reach 90% in 4 years. The quicker the funded ratio is achieved, the less exposed the Plan is to market volatility.

- In addition to the tax, the City would commit to continuing the current level of contributions of 28.88% of payroll, at a minimum, as long as the tax is in place. The Public Safety Sales Tax would not supplant the existing funding. When the tax ends, the City will commit to making the actuarial recommended contribution annually to maintain the funded ratio at 90%.
- The City should direct a portion of all future funds received from settlement of lawsuits with the cell phone providers to the Plan.
- The Board believes it is important for the City to reduce expenses in the general fund as much as reasonably possible without impacting the core services and public safety. This will assist in providing additional funding of the Plan.
- The City needs to redefine disability. The City does not have any modified job descriptions that allow a police officer or firefighter, who has been injured but can still perform most aspects of the job, to remain as an active employee. If accommodations could be made, the disability rate would decline and have a positive impact on the contribution rate.

RETIREMENT BENEFITS

The members of the Board of Trustees strongly believe the retirement security of the police and fire employees is critical. Employees have planned their careers and retirement based on these benefits and the City of Springfield has a responsibility to deliver the benefits promised.

It should be noted that the Board is strongly opposed to any reduction in benefits for employees and retirees. Assuming the voters would approve such action, any reduction in existing benefits would not only create a major and lasting breach of confidence and trust with our past and present employees, it would also create a serious barrier to effective recruitment of future employees. An inability to fill existing positions in turn creates a substantial risk to public safety and decreases the money available for the pension fund. Finally, though not least in our estimation, we could not support a breach of faith with those men and women who have placed themselves in harm's way by reducing the financial support on which they depend when the job is done.

The members of the Board of Trustees are committed to working with the members of City Council to develop a solution to improve the stability of the Police Officers' and Firefighters' Retirement System. We feel a dedicated funding source is required and we will work with the members of City Council and Plan participants to explain this need to the community. It is important this issue be resolved timely for both the financial stability of the City of Springfield and the retirement security of the members of the Plan. The longer this issue goes unresolved, the more expensive the solution.